

TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

SUBJECT: Update on Legislation

ITEM NUMBER: 7

ATTACHMENT(S): 4

ACTION: X

MEETING DATE: June 5, 2002

INFORMATION:

PRESENTER: Ed Derman

SUMMARY OF STATE LEGISLATION

Staff has prepared the attached analyses and recommended positions on the following measures for the Board's consideration.

<u>Attachment</u>	<u>Bill Number</u>	<u>Author</u>	<u>Subject</u>
1	AB 1995	Correa	Provision Of Non-Audit Services
2	AB 2970	Wayne	Auditor "Cooling-Off" Period
3	SB 1527	Burton	Provision Of Non-Audit Services
4	Legislative Summary		

Mr. Derman will provide a verbal update at the meeting.

Assembly Bill 1995

Assembly Member Correa (As amended 5/13/02)

Position:

Support (Staff recommendation)

Proponents:

CALPIRG, Center for Public Interest Law, Congress of CA Seniors, Consumer Attorneys of CA, Consumers Union, Foundation for Taxpayer and Consumer Rights

Opponents:

Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, CA Chamber of Commerce, CA Society of Certified Public Accountants

SUMMARY

Assembly Bill 1995 limits the services a California accountant or accounting firm that certifies corporate financial statements can perform for an audit client. Such accountants or firms could only perform tax preparation services or review Securities and Exchange Commission (SEC) filings in addition to their audit services.

HISTORY

SB 1527 (Burton, 2002) requires accountancy partnerships or corporations registering with the Board of Accountancy to certify that the partnership or corporation will not provide, or will not knowingly have a financial interest in, any non-audit services to an audit client that is a publicly traded corporation.

H.R. 3763 (Oxley) prohibits independent auditing firms from providing internal auditing and financial computer system consulting, but permits tax consulting. Permits the SEC to determine additional prohibited services.

S. 2004 (Dodd—Corzine) prohibits accounting firms from providing external auditing and non-auditing services to a client, but allows the provision of tax consulting services if approved in advance by the auditing committee of a client company's board of directors.

S. 2460 (Levin) prohibits an accounting firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.

BACKGROUND

As a major investor in domestic equity and fixed-income markets, the California State Teachers' Retirement System (CalSTRS) and its investment managers rely, among other things, on corporate financial statements and independent audits performed by outside accountants in order to make informed investment decisions. Accurate financial statements and reliable independent

audits are also vital tools in assessing the true value of CalSTRS' investments. The failure of Enron and the role their independent auditor, Arthur Andersen LLP, played in it, exposed the inadequacy of safeguards to protect investors from questionable accounting practices and major conflicts of interest between auditors and their audit clients.

While approximately half the income Andersen generated from its business relationship with Enron was attributed to its role as independent auditor, the other half was generated from the consulting services it provided to the company, such as the development of an automated internal accounting system. Many have expressed concerns that Andersen's duty to accurately reflect Enron's condition in the financial statements it certified was compromised by its effort to improve Andersen's finances by also serving as an accounting consultant to Enron. This practice of providing consulting services to audit clients has become an increasingly common occurrence within the accounting industry and calls into question the independence and objectivity of all independent auditors. From 1993 to 1999, the average annual growth rate for revenues from non-audit services has been 26 percent, while comparable growth rates for audit and tax services have been, 9 percent and 13 percent, respectively over the same period.

Responsibility for the oversight and setting of standards for auditors and the accounting industry is spread among numerous state and federal government agencies and professional organizations. The SEC sets disclosure requirements for securities that are bought and sold in U.S. markets and requires an independent accounting firm audit corporate financial reports annually. The SEC can fine and/or bar accountants from auditing publicly traded companies if they have violated SEC disclosure rules.

The SEC also has the statutory authority to set accounting rules. It has, however, delegated this task to the non-profit Financial Accounting Foundation (FAF). The FAF is run by 16 trustees, the majority of whom are accounting industry representatives. The FAF oversees, funds, and selects the members of the Financial Accounting Standards Board, a 7-member body that sets the rules for how public companies keep their financial records. The American Institute of Certified Public Accountants (AICPA), a professional society, also performs a peer-review function through its ethics division and various oversight committees. However, the most severe disciplinary action imposed by the AICPA is to expel a member from the organization for unprofessional conduct.

Besides regulating most forms of corporate conduct, individual states license accountants and set practice standards. Through statute and regulations, the California Board of Accountancy determines what services an accountant, accounting partnership or accountancy corporation working in the state may provide to a client, specifies what constitutes a conflict of interest, and establishes disclosure requirements and other rules of professional conduct. It also has the authority to strip an accountant of their license for violating these laws, regulations, and other professional standards, including generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS).

Existing law requires accounting partnerships and corporations that provide auditing services to undergo a structured peer review of their work before they may renew their license or registration. Board of Accountancy regulations also requires accountants that perform auditing

services for government and the private sector to take continuing education classes in the subject. Recently, the Board of Accountancy has made matters related to the audit of public companies a priority because members of the Board believe abuses in this area represent the greatest danger to the consumer.

In April 2002, the Board of Accountancy released its Report and Recommendations on Audit Standards and Practices, which addressed four key areas: 1) record retention and working paper documentation; 2) the influence of non-audit services on auditor independence and objectivity; 3) auditors becoming employees of their clients; and 4) auditor's responsibility to detect and report errors and irregularities. The report included proposed legislation that specifically defines what constitutes audit services and also prohibits auditors of public companies from providing specified non-audit services to their audit clients. According to the report, their list of prohibited services would be consistent with SEC rules, adding two non-audit services to the list of prohibited services (information technology systems design and internal audit outsourcing).

Proposals dealing with issues of investor protection, accounting oversight and corporate governance continue to circulate in Congress, state legislatures, the SEC, and self-regulating industry groups. According to CalSTRS' Washington counsel, a consensus on the proper elements of a new regulatory framework has not formed, and the prospects for passage of reform legislation at the federal level remain unclear.

DISCUSSION

Assembly Bill 1995 limits the services a certified public accountant or accounting firm licensed by the state may perform for an audit client to:

- Work performed in the course of forming an opinion regarding financial statements.
- Preparation of tax returns and tax planning advice related to the preparation and filing of returns.
- Review of documents filed with the SEC during the period under audit.
- Attending meetings with a client's audit committee or board of directors, as well as annual shareholders meetings.
- Reissuing audit opinions from prior periods and preparation of documents relating to SEC filings.
- Communications regarding GAAP and other financial reporting issues.
- Responding to regulatory inquiries, including inquiries by the SEC, relative to a client's fiscal period audited by the licensee.
- Communicating with predecessor and successor accounting firms.

- Preparation of management recommendation letters that are an integral part of the audit process.
- Providing testimony to government agencies, legislative inquiries, or in court proceedings regarding audit work performed.
- Other services specified by the state Board of Accountancy that meet specified criteria.

According to the author, AB 1995 responds to an issue exposed by the bankruptcy of the Enron Corporation after its auditor, Arthur Andersen LLP, who also performed non-audit consulting services for the company, revised Enron's financial statements to reflect a major loss over a span of several years. He believes the practice of certifying inaccurate corporate financial statements is not isolated to this incident, and represents a continuing problem within the accounting industry that must be addressed.

AB 1995 generally reflects the recommendations made by the California Board of Accountancy. Rather than prohibiting specified non-audit services and allowing the provision of all other services to public companies, as recommended by the Board, however, AB 1995 specifies the types of non-audit services that can be provided, and bans the provision of all other non-audit services to their public and private audit clients. All the authorized services specified by the bill relate in some way to the performance of independent audits and preparation of tax returns. In addition, AB 1995 applies to a larger group of audit clients by forcing auditors of private companies to follow its requirements, and, by prohibiting the provision of any service not listed, is somewhat more restrictive than the Board's proposal.

In effect, AB 1995 authorizes the California Board of Accountancy to discipline accountants and accounting firms working in California that perform unauthorized services for their outside audit clients up to, and including, the suspension and revocation of their licenses. Because any accountant or firm that works in California or serves California clients must obtain a license from the Board of Accountancy and a licensee working for a California client in another state must continue to follow California law, AB 1995 provides investors a greater degree of comfort in the audited financial statements of California companies. It does not affect, of course, the activities of companies and auditors operating outside of California. As a result, adoption of this proposal at the federal level would be of more widespread effectiveness.

The authorized services specified in AB 1995 are consistent with those permitted by SB 1527. The provisions of SB 1527, however, apply only to accounting partnerships and accountancy corporations that provide independent auditing services to publicly traded corporations. Furthermore, AB 1995 specifically permits the Board of Accountancy to expand the list of authorized services under certain conditions, while SB 1527, which also defines audit services and non-audit services, does not. While the two bills differ in their various provisions (being more restrictive in some areas and less in others) both would improve auditor independence to a similar degree.

With the significant change in the role of external audit firms, and internal audit/financial reporting, the CalSTRS Investment Committee and its Subcommittee on Corporate Governance

has approved an extensive plan to promote financial market reforms, including strengthening standards related to corporate audit committee accountability, external auditor independence and disclosure. CalSTRS supports limiting the non-audit services that an external auditor provides a corporation to taxation issues, as well as preventing external auditors from directly investing in audit clients and their affiliates. The Investment Committee has amended the CalSTRS Statement of Investment Responsibility to reflect the change, allowing CalSTRS, as a shareholder, to vote against the selection or retention of an external auditor that violates those policies. The provisions of AB 1995 mirror the recommendations adopted by the CalSTRS Investment Committee regarding external auditor independence and provide another means to ensure that external auditors and publicly traded companies comply with CalSTRS' corporate governance policies.

FISCAL IMPACT

Benefit Program Costs – None

Administrative Costs – None

RECOMMENDATION

Support. This bill is consistent with the CalSTRS policy that a corporation should limit the non-audit services it receives as an audit client to taxation issues and advances the System's implementation plan regarding financial market reform. It would, within California, prevent a clear conflict of interest between an independent auditor's duty to investors that need reliable information on the financial state of a company, and their audit client's desire to portray its financial state in the best possible light. A federal limitation, however, is a preferred approach.

Assembly Bill 2970

Assembly Member Wayne (As amended 4/29/02)

Position:

Support, if amended (Staff recommendation)

Proponents:

CALPIRG, Center for Public Interest Law, Congress of CA Seniors, Consumer Attorneys of CA, Consumers Federation of CA, Consumers Union

Opponents:

None on File

SUMMARY

Assembly Bill 2970 prohibits a California-licensed external auditor for a publicly traded corporation from accepting employment with that corporation or its affiliate, within 24 months of performing an audit or issuing a financial statement on behalf of the corporation.

HISTORY

S. 2004 (Dodd-Corzine) among other things, requires a 2-year cooling-off period for an auditor to serve in a senior financial position for a client.

S. 2460 (Levin) prohibits an accounting firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.

BACKGROUND

As a major investor in domestic equity and fixed-income markets, the California State Teachers' Retirement System (CalSTRS) and its investment managers rely, among other things, on corporate financial statements and independent audits performed by outside accountants in order to make informed investment decisions. Accurate financial statements and reliable independent audits are also vital tools in assessing the true value of CalSTRS' investments.

The failure of Enron and the role their independent auditor, Arthur Andersen, played in it, exposed the inadequacy of safeguards to protect investors from questionable accounting practices and major conflicts of interest between auditors and their audit clients. While some former Arthur Andersen employees worked for Enron at the time of Enron's failure, the outcome of the accounting firm's work for another audit client, Waste Management, Inc., illustrates how the practice of auditors becoming employees of their former clients can call into question the accuracy of financial reports certified by external auditors.

In February 1998, Waste Management restated its pre-tax earnings, reducing them by \$1.43 billion for the period from 1992 through the third quarter of 1998 to correct a previous accounting error. A subsequent Securities and Exchange Commission (SEC) investigation found that Arthur Andersen had certified false and misleading audit reports of Waste Management's financial statements from 1993 to 1996. The accounting firm settled with the SEC in June 2001 without admitting any wrongdoing by paying \$7 million in civil penalties. While the settlement order alleged various abuses of generally accepted accounting principles, it also noted that until the time of the restatement, every chief financial or accounting officer in Waste Management's tenure as a public company had previously been an auditor for Arthur Andersen. In fact, 14 former Arthur Andersen employees served in key financial and accounting positions for Waste Management during the 1990's.

Responsibility for the oversight and setting of standards for auditors and the accounting industry is spread among numerous state and federal government agencies and professional organizations. The SEC sets disclosure requirements for securities that are bought and sold in U.S. markets and requires an independent accounting firm audit corporate financial reports annually. The SEC can fine and/or bar accountants from auditing publicly traded companies if they have violated SEC disclosure rules.

The SEC also has the statutory authority to set accounting rules. It has, however, delegated this task to the non-profit Financial Accounting Foundation (FAF). The FAF is run by 16 trustees, the majority of whom are accounting industry representatives. The FAF oversees, funds, and selects the members of the Financial Accounting Standards Board, a 7-member body that sets the rules for how public companies keep their financial records. The American Institute of Certified Public Accountants, a professional society, also performs a peer-review function through its ethics division and various oversight committees. However, the most severe disciplinary action imposed by the AICPA is to expel a member from the organization for unprofessional conduct.

Besides regulating most forms of corporate conduct, individual states license accountants and set practice standards. Through statute and regulations, the California Board of Accountancy determines what services an accountant or accountancy corporation licensed in the state may provide to a client, specifies what constitutes a conflict of interest, and establishes disclosure requirements and other rules of professional conduct. It also has the authority to strip an accountant of his or her license for violating these laws and regulations. Recently, the Board of Accountancy has made matters related to the audit of public companies a priority because the Members of the Board believe abuses in area represent the greatest danger to the consumer.

In April 2002, the Board of Accountancy released its Report and Recommendations on Audit Standards and Practices, which addressed four key areas: 1) record retention and working paper documentation; 2) the influence of non-audit services on auditor independence and objectivity; 3) auditors becoming employees of their clients; and 4) auditor's responsibility to detect and report errors and irregularities. The report included proposed legislation that would prohibit accountants from taking a job with a former audit client if they had performed auditing work for the client within the last two years, depending on the extent of their involvement in the audit and the nature of the position offered.

According to the Board's report: "As technically skilled audit personnel become exposed to their client's business operations through the audit process, they become potentially valuable employees to the client. These relationships may lead to lucrative employment opportunities in positions such as Controller or Chief Financial Officer." The report went on to note that conflicts arise when an auditor's objectivity is compromised by promises or expectations of obtaining a high-level job with the audit client, or out of consideration for a former coworker that now works for the audit client.

Proposals dealing with issues of investor protection, accounting oversight and corporate governance continue to circulate in Congress, state legislatures, the SEC, and self-regulating industry groups. According to CalSTRS' Washington counsel, a consensus on the proper elements of a new regulatory framework has not formed, and the prospects for passage of reform legislation at the federal level remain unclear.

DISCUSSION

Assembly Bill 2970 prohibits a state licensed accountant who performs independent auditing services for a publicly traded corporation from accepting employment with that company or its affiliate within 24 months of issuing a financial statement, if the accountant:

- Participated in the audit process in a position ranging from the person in charge of fieldwork through the partner managing the engagement.
- Would be able to exercise significant authority over the corporation's accounting or financial reporting.

According to the author, AB 2970 would protect an external auditor's independence and serve consumers' best interests by creating a "cooling-off period" that would prohibit employment with a former audit client for 24-months following any significant involvement in providing audit services.

In effect, this bill authorizes the California Board of Accountancy to discipline a licensed accountant who violates the terms of the employment ban. While the Board of Accountancy recommends a two-year ban, the task force it charged with drafting the original report recommended a one-year cooling-off period. The Board rejected that proposal, concluding that two years would provide greater consumer protection. Because any accountant or firm that works in California or serves California clients must obtain a license from the Board of Accountancy and a licensee working for a California client in another state must continue to follow California law, AB 2970 applies to any accountant who works in California or audits a California company. It does not affect, of course, the activities of companies and auditors operating outside of California. As a result, adoption of this proposal at the federal level would be of more widespread effectiveness.

With the significant change in the role of external audit firms, and internal audit/financial reporting, the CalSTRS Investment Committee and its Subcommittee on Corporate Governance has approved an extensive plan to promote financial market reforms, including strengthening

standards related to corporate audit committee accountability, external auditor independence and disclosure. CalSTRS supports a one-year cooling-off period regarding the employment, as either Staff or a Member of the Board of Directors, of persons on the companies' external audit team or senior management of the external audit firm. The Investment Committee has amended the CalSTRS Statement of Investment Responsibility to reflect the change, allowing CalSTRS, as a shareholder, to vote against the selection or retention of an external auditor or board member that violates this policy.

The two-year ban imposed by AB 2970 is more restrictive than CalSTRS policy and would limit employment opportunities for those auditors affected. A one-year cooling-off period is consistent with employment restrictions placed on former state officials, which prevent them from receiving compensation for communicating with their former agency in an attempt to influence agency decisions. A similar one-year ban is placed on legislators and other elected state officers.

FISCAL IMPACT

Benefit Program Costs – None

Administrative Costs – None

RECOMMENDATION

Support, if amended to limit the “cooling-off period” to one year. This is consistent with the CalSTRS Investment Committee’s position, as well as the System’s implementation plan regarding financial market reform. It would, within California, help maintain an independent auditor’s duty to investors that need reliable information on the financial state of publicly traded corporations without unreasonably restricting career opportunities for accountants. A federal limitation, however, is a preferred approach.

Senate Bill 1527

Senator Burton (As amended 4/16/02)

Position:

Support (Staff recommendation)

Proponents:

Consumers Union, Consumer Attorneys of CA, Consumer Federation of CA

Opponents:

Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, CA Society of Certified Public Accountants, CA Manufacturers and Technology Association

SUMMARY

Senate Bill 1527 requires an accounting partnership or accountancy corporation to certify that it will not provide non-audit services to an audit client that is a publicly traded corporation. In addition, it would make an accountancy partnership or corporation that violates these requirements subject to discipline for unprofessional conduct.

HISTORY

AB 1995 (Correa, 2000) limits the services a California accountant or accounting firm that certifies corporate financial statements can perform for their audit client to tax preparation services and the review of Securities and Exchange Commission (SEC) filings.

H.R. 3763 (Oxley) prohibits independent auditing firms from providing internal auditing and financial computer system consulting, but permits tax consulting. Permits the SEC to determine additional prohibited services.

S. 2004 (Dodd—Corzine) prohibits accounting firms from providing external auditing and non-auditing services to a client, but allows the provision of tax consulting services if approved in advance by the auditing committee of a client company's board of directors.

S. 2460 (Levin) prohibits an accounting firm from auditing its own work and from providing non-auditing services to a company during the course of its audit contract and for two years afterward.

BACKGROUND

As a major investor in domestic equity and fixed-income markets, the California State Teachers' Retirement System (CalSTRS) and its investment managers rely, among other things, on corporate financial statements and independent audits performed by outside accountants in order to make informed investment decisions. Accurate financial statements and reliable independent

audits are also vital tools in assessing the true value of CalSTRS' investments. The failure of Enron and the role their independent auditor, Arthur Andersen LLP, played in it, exposed the inadequacy of safeguards to protect investors from questionable accounting practices and major conflicts of interest between auditors and their audit clients.

While approximately half the income Andersen generated from its business relationship with Enron was attributed to its role as independent auditor, the other half was generated from the consulting services it provided to the company, such as the development of an automated internal accounting system. Many have expressed concerns that Andersen's duty to accurately reflect Enron's condition in the financial statements it certified was compromised by its effort to improve Andersen's finances by also serving as an accounting consultant to Enron. This practice of providing consulting services to audit clients has become an increasingly common occurrence within the accounting industry and calls into question the independence and objectivity of all independent auditors. From 1993 to 1999, the average annual growth rate for revenues from non-audit services has been 26 percent, while comparable growth rates for audit and tax services have been, 9 percent and 13 percent, respectively over the same period.

Responsibility for the oversight and setting of standards for auditors and the accounting industry is spread among numerous state and federal government agencies and professional organizations. The SEC sets disclosure requirements for securities that are bought and sold in U.S. markets and requires an independent accounting firm audit corporate financial reports annually. The SEC can fine and/or bar accountants from auditing publicly traded companies if they have violated SEC disclosure rules.

The SEC also has the statutory authority to set accounting rules. It has, however, delegated this task to the non-profit Financial Accounting Foundation (FAF). The FAF is run by 16 trustees, the majority of whom are accounting industry representatives. The FAF oversees, funds, and selects the members of the Financial Accounting Standards Board, a 7-member body that sets the rules for how public companies keep their financial records. The American Institute of Certified Public Accountants (AICPA), a professional society, also performs a peer-review function through its ethics division and various oversight committees. However, the most severe disciplinary action imposed by the AICPA is to expel a member from the organization for unprofessional conduct.

Besides regulating most forms of corporate conduct, individual states license accountants and set practice standards. Through statute and regulations, the California Board of Accountancy determines what services an accountant, accounting partnership or accountancy corporation working in the state may provide to a client, specifies what constitutes a conflict of interest, and establishes disclosure requirements and other rules of professional conduct. It also has the authority to strip an accountant of his or her license for violating these laws, regulations, and other professional standards, including generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS).

Existing law requires accounting partnerships and corporations that provide auditing services to undergo a structured peer review of their work before they may renew their license or registration. Board of Accountancy regulations also requires accountants that perform auditing

services for government and the private sector to take continuing education classes in the subject. Recently, the Board of Accountancy has made matters related to the audit of public companies a priority because members of the Board believe abuses in this area represent the greatest danger to the consumer.

In April 2002, the Board of Accountancy released its Report and Recommendations on Audit Standards and Practices, which addressed four key areas: 1) record retention and working paper documentation; 2) the influence of non-audit services on auditor independence and objectivity; 3) auditors becoming employees of their clients; and 4) auditor's responsibility to detect and report errors and irregularities. The report included proposed legislation that specifically defines what constitutes audit services and also prohibits auditors of public companies from providing specified non-audit services to their audit clients. According to the report, their list of prohibited services would be consistent with SEC rules, adding two non-audit services to the list of prohibited services (information technology systems design and internal audit outsourcing).

Proposals dealing with issues of investor protection, accounting oversight and corporate governance continue to circulate in Congress, state legislatures, the SEC, and self-regulating industry groups. According to CalSTRS' Washington counsel, a consensus on the proper elements of a new regulatory framework has not formed, and the prospects for passage of reform legislation at the federal level remain unclear.

DISCUSSION

Specifically, Senate Bill 1527:

- Requires an accounting partnership or corporation that applies for a license from the Board of Accountancy to include a certification that it will not provide non-audit services to an audit client.
- Prohibits external auditors from knowingly having a direct financial interest in non-audit services that are provided to a client.
- Defines an audit as any service that results in, or relates to, the delivery of a corporate financial statement according to specified professional standards used to conduct external audits of publicly traded corporations.
- Specifies prohibited non-audit services.
- Provides several non-audit services that can permissibly be offered to audit clients, including tax preparation and services directly related to the delivery of an external audit, including attending meetings or responding to regulatory inquiries.
- Specifies that failure to comply with the certification may result in censure, suspension, revocation, or refusal to renew a license to practice.

According to the author, SB 1527 would address the issue of auditor independence by requiring accounting partnerships and accountancy corporations to certify, in their applications for a license to practice in the state, that they will not provide prohibited non-audit services to their audit clients.

SB 1527 requires only accounting partnerships and accounting corporations to certify that they will not provide non-audit services to outside audit clients that are publicly traded corporations. – individual licensees would not be subject to its provisions. The bill mirrors the recommendations made by the Board of Accountancy by defining what constitutes audit services, non-audit services and authorized non-audit services. All the authorized services relate in some way to the performance of independent audits and preparation of tax returns.

In addition, SB 1527 specifically authorizes the Board of Accountancy to discipline accounting partnerships and accounting corporations working in California that perform unauthorized non-audit services for their outside audit clients. Since any accountant or firm that works in California or serves California clients must obtain a license from the Board of Accountancy, and a licensee working for a California client in another state must continue to follow California law, SB 1527 provides investors a greater degree of confidence in the audited financial statements of California companies. It does not affect, of course, the activities of companies and auditors operating outside of California. As a result, adoption of this proposal at the federal level would be of more widespread effectiveness.

The authorized non-audit services specified in SB 1527 are consistent with those permitted by AB 1995. The provisions of AB 1995, however, apply to all accountants and accounting firms that provide independent auditing services to private and public companies. In addition, AB 1995 specifically permits the Board of Accountancy to expand the list of authorized services under certain conditions, while SB 1527, does not. While the two bills differ in their various provisions (being more restrictive in some areas and less in others) both would improve auditor independence to a similar degree.

With the significant change in the role of external audit firms, and internal audit/financial reporting, the CalSTRS Investment Committee and its Subcommittee on Corporate Governance has approved an extensive plan to promote financial market reforms, including strengthening standards related to corporate audit committee accountability, external auditor independence and disclosure. CalSTRS supports limiting the non-audit services that an external auditor provides a corporation to taxation issues, as well as preventing external auditors from directly investing in audit clients and their affiliates. The Investment Committee has amended the CalSTRS Statement of Investment Responsibility to reflect the change, allowing CalSTRS, as a shareholder, to vote against the selection or retention of an external auditor that violates those policies. The provisions of SB 1527 mirror the recommendations adopted by the CalSTRS Investment Committee regarding external auditor independence and provide another means to ensure that external auditors and publicly traded companies comply with CalSTRS' corporate governance policies.

FISCAL IMPACT

Benefit Program Costs – None

Administrative Costs – None

RECOMMENDATION

Support. This measure is consistent with the CalSTRS policy that a corporation should limit the non-audit services it receives as an audit client to taxation issues, as well as the System's implementation plan regarding financial market reform. It would, within California, prevent a clear conflict of interest between an independent auditor's duty to investors that need reliable information on the financial state of a company, and their audit client's desire to portray its financial state in the best possible light. A federal limitation, however, is a preferred approach.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
LEGISLATIVE SUMMARY – INVESTMENT COMMITTEE
2001-2002 Regular Session – May 15, 2002

BILL NO.	INFORMATION
AB 1995	<p>AUTHOR: Assembly Member Correa TITLE: Provision of non-audit services AMENDED: 5/13/02 LOCATION: Assembly Floor BOARD POSITION: Support (Staff recommendation)</p> <p>SUMMARY: Prohibits a California accountant from certifying corporate financial statements if his or her accounting firm performs non-audit services for their client, other than tax preparation and SEC document review.</p> <p>COSTS: Benefit program – None Administrative – None</p> <p>P – CALPIRG, Center for Public Interest Law, Congress of CA Seniors, Consumer Attorneys of CA, Consumers Union, Foundation for Taxpayer and Consumer Rights O – CA Chamber of Commerce, CA Society of Certified Public Accountants, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PriceWaterhouseCoopers LLP</p>
AB 2970	<p>AUTHOR: Assembly Member Wayne TITLE: Auditor “cooling-off” period AMENDED: 4/29/02 LOCATION: Assembly Floor BOARD POSITION: Support (Staff recommendation)</p> <p>SUMMARY: Requires a two-year cooling-off period before an independent auditor may accept a senior-management job with a former audit client.</p> <p>COSTS: Benefit program – None Administrative – None</p> <p>P – CALPIRG, CPIL, Congress for California Seniors, Consumer Attorneys of California, Consumer Federation of California, Consumers Union O – None known</p>

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
LEGISLATIVE SUMMARY – INVESTMENT COMMITTEE
2001-2002 Regular Session – May 15, 2001

BILL NO.	INFORMATION
SB 1527	<p>AUTHOR: Senator Burton TITLE: Provision of non-audit services AMENDED: 4/16/02 LOCATION: Senate Appropriations BOARD POSITION: Support (Staff recommendation)</p> <p>SUMMARY: Prohibits a California accountant from certifying corporate financial statements if their accounting firm performs non-audit services for their client, other than tax preparation and SEC document review.</p> <p>COSTS: Benefit program – None</p> <p>Administrative – None</p> <p>P – Consumers Union, Consumer Attorneys of California, Consumer Federation of California</p> <p>O – CA Manufacturers and Technology Association, CA Society of Certified Public Accountants, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, PriceWaterhouseCoopers LLP</p>
SJR 9	<p>AUTHOR: Senator Costa TITLE: Foreign investments LOCATION: Senate B, C & IT BOARD POSITION: Support, if amended*</p> <p>SUMMARY: Requests that the President and Congress identify and place on a federal list, investments in foreign businesses that pose a threat to the national security interests of the U.S. and to encourage appropriate federal measures to deny these entities access to capital from the U.S.</p> <p>COSTS: Benefit program – None</p> <p>Administrative – No direct fiscal impact</p> <p>P – CalPERS</p> <p>O – None known</p>

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
LEGISLATIVE SUMMARY – INVESTMENT COMMITTEE
2001-2002 Regular Session – May 15, 2001

BILL NO.	INFORMATION
SR 22	<p>AUTHOR: Senator Dunn TITLE: Investments in wholesale energy companies LOCATION: Senate E, U & C BOARD POSITION: No position, if amended (Staff recommendation)</p> <p>SUMMARY: Requests that each state agency, including CalSTRS, consider whether or not to continue to own stocks, shares or other financial investments in or participate in a joint venture or partnership with any wholesale energy related business that has refused to comply with a subpoena issued by the Senate Select Committee to Investigate Price Manipulation of the Wholesale Energy Market.</p> <p>COSTS: Benefit program – None Administrative – None</p> <p>P – None known O – None known</p>

LEGEND OF ABBREVIATIONS

P = PROPONENTS O = OPPONENTS

<u>ABBREVIATION</u>	<u>ORGANIZATION</u>
AARP	American Association of Retired Persons, State Legislative Committee
AALA	Associated Administrators of Los Angeles
ACCCA	Association of California Community College Administrators
ACSA	Association of California School Administrators
AFSCME	American Association of State, County and Municipal Employees
AFT	American Federation of Teachers
AGENCY	State and Consumer Services Agency
A.R.E.	Association of Retirees for Equity
ART	Association of Retired Teachers
BOE	Board of Equalization
BOG	Board of Governors, California Community Colleges
Cal-Tax	California Taxpayers Association
CalPERS	California Public Employees' Retirement System
CalSTRS	California State Teachers' Retirement System
CALPIRG	California Public Interest Research Group
CASBO	California Association of School Business Officials
CCA	Community College Association
CCAE	California Council for Adult Education
CCC	California Community Colleges
CCPOA	California Correctional Peace Officers Association
CFA	California Faculty Association
CFT	California Federation of Teachers
CNEC	California Network of Educational Charters
CPCA	California Police Chiefs' Association
CPFFA	California Professional Firefighters Association
CPIL	Center for Public Interest Law
CRTA	California Retired Teachers Association
CSAC	California State Association of Counties
CSBA	California School Boards Association
CSEA	California School Employees Association
CSL	California Senior Legislature
CSU	California State University
CTA	California Teachers Association
DOE	Department of Education
DOF	Department of Finance
DGS	Department of General Services
DPA	Department of Personnel Administration

LEGEND OF ABBREVIATIONS

P = PROPONENTS O = OPPONENTS

<u>ABBREVIATION</u>	<u>ORGANIZATION</u>
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EGTRRA	Economic Growth and Tax Relief Reconciliation Act of 2001
FACCC	Faculty Association of California Community Colleges
F.A.I.R.	Faculty Attempting to Improve Retirement
FCPHE	Faculty Coalition for Public Higher Education
FTB	Franchise Tax Board
LACCD	Los Angeles Community College District
LADSA	Los Angeles Deputy Sheriffs' Association
LAUSD	Los Angeles Unified School District
OCDE	Orange County Department of Education
PARS	Public Agency Retirement System
PERF	Public Employees Retirement Fund
PORAC	Peace Officers Research Association of California
RPEA	Retired Public Employees Association
SACRS	State Association of County Retirement Systems
SBMA	Supplemental Benefit Maintenance Account
SCSA	State and Consumer Services Agency
SDCOE	San Diego County Office of Education
SEIU	Service Employees International Union
SLC	State Lands Commission
SSC	School Services of California
SSDA	Small School Districts' Association
START	State Teachers' Automation Redesign Team
TRB	Teachers' Retirement Board
TRF	Teachers' Retirement Fund
TRL	Teachers' Retirement Law
UTLA	United Teachers of Los Angeles

STANDING COMMITTEES OF THE ASSEMBLY/SENATE

Assembly PER&SS	Assembly Public Employees, Retirement and Social Security Committee
Senate B, C & IT	Senate Banking, Commerce and International Trade Committee
Senate E, U & C	Senate Energy, Utilities and Communications Committee
Senate PE&R	Senate Public Employment and Retirement Committee